

ORIGINAL

Municipality of Valley Springs, South Dakota
Audit Report
Two Years Ended December 31, 2003

Municipality of Valley Springs, South Dakota
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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Municipal Council
Municipality of Valley Springs, South Dakota

I have audited the primary government financial statements of the Municipality of Valley Springs, South Dakota, as of December 31, 2003 and for the two years then ended and have issued my report thereon dated May 4, 2005, which was qualified because of the lack of fixed asset records and because the financial statements do not include all of the assets, liabilities, revenues and expenditures of the municipality. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Valley Springs' financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. I noted certain immaterial instances of noncompliance that I have reported to the management of the Municipality of Valley Springs in a separate communication dated May 4, 2005.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Municipality of Valley Springs' internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, I noted certain matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect the

Municipality of Valley Springs' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of current audit findings and questioned costs as items 2003-01 and 2003-02. I also noted other matters involving the internal control over financial reporting that I have reported to the management of the Municipality of Valley Springs in a separate communication dated May 4, 2005.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, I consider items 2003-01 and 2003-02 to be material weaknesses.

This report is intended solely for the information and use of the South Dakota Legislature, the governing board and management of the Municipality of Valley Springs and is not intended to be and should not be used by anyone other than these specified parties. However, as required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.

May 4, 2005

Donald E. Finstad, CPA
DONALD E. FINSTAD, CPA

Municipality of Valley Springs
Schedule of Prior Audit Findings and Questioned Costs

SCHEDULE OF PRIOR AUDIT FINDINGS AND QUESTIONED COSTS:

Prior Other Audit Findings:

Finding Number 2001-1:

A reportable condition and material weakness in internal controls was noted due to a lack of segregation of duties for revenues, expenditures and payroll resulting in decreased reliability of reported financial data and increased potential for the loss of public assets.

Corrective Action Plan:

This finding has not been corrected and is restated under the current other audit findings as Finding Number 2003-01.

Finding Number 2001-02:

The municipality has not established and maintained adequate records of its general fixed assets and enterprise fund fixed assets.

Corrective Action Plan:

This finding has not been corrected and is restated under the current other audit findings as Finding Number 2003-02.

Municipality of Valley Springs
Schedule of Current Audit Findings and Questioned Costs

SCHEDULE OF CURRENT AUDIT FINDINGS AND QUESTIONED COSTS:

Current Other Audit Findings:

Finding Number 2003-01:

A reportable condition and material weakness in internal controls was noted due to a lack of segregation of duties for revenues, expenditures and payroll resulting in decreased reliability of reported financial data and increased potential for the loss of public assets.

Analysis:

The municipal finance officer is involved in or has the opportunity to be involved in the processing of all revenue, expenditure and payroll transactions from beginning to end. The municipal finance officer also reconciles bank statements and maintains official accounting records with little oversight or review. As a result, an inadequate segregation of duties exists for the revenue, expenditure and payroll functions for the Municipality of Valley Springs.

Recommendation:

1. I recommend that the Municipality of Valley Springs officials be cognizant of this lack of segregation of duties for revenue, expenditures and payroll and attempt to provide compensating internal controls whenever and wherever possible and practical.

Corrective Action Plan:

The municipality is cognizant of this lack of segregation of duties and will provide compensating internal controls whenever and wherever possible and practical.

Finding Number 2003-02:

The municipality has not established and maintained adequate records of its general fixed assets and enterprise fund fixed assets.

Analysis:

Fixed asset records should be maintained to:

- (1) facilitate the efficient use of its fixed assets,
- (2) establish an accountability for a significant portion of the municipality's assets,
- (3) facilitate financial reporting in accordance with generally accepted accounting principles, and
- (4) aid in the determination of the cost of providing services to users for its enterprise fund operations.

The municipality does not have fixed asset records that accomplish the above objectives. Consequently, amounts reported for general fixed assets, enterprise fund fixed assets, accumulated depreciation and related depreciation expense cannot be verified as to their propriety. The absence of these records makes it more difficult to manage the use of its assets efficiently and also fails to establish an accountability for a significant portion of the municipality's assets. Finally, the lack of these records precludes the municipality from accurately determining the cost of services provided to users in that depreciation expense cannot be accurately determined.

Recommendations:

2. I recommend that adequate fixed asset records be established and maintained for general fixed assets and enterprise fund fixed assets.

Corrective Action Plan:

The municipality has adopted a fixed asset capitalization policy and is in the planning stage of establishing fixed asset records for its general fixed assets and its enterprise fund fixed assets.

INDEPENDENT AUDITOR'S REPORT

Municipal Council
Municipality of Valley Springs, South Dakota

I have audited the accompanying primary government financial statements of the Municipality of Valley Springs, South Dakota as of December 31, 2003, and for the two years then ended, as listed in the Table of Contents. These financial statements are the responsibility of the Municipality of Valley Springs' management. My responsibility is to express an opinion on these financial statements based on my audit.

Except as discussed in the following paragraph, I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

The municipality has not established and maintained adequate records relating to general fixed assets and enterprise fund fixed assets, accumulated depreciation, and related depreciation expense. In addition, the condition of the records did not allow the application of alternative procedures to allow me to satisfy myself with respect to these reported amounts.

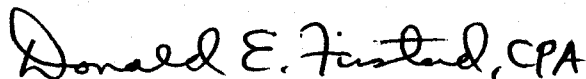
The primary government financial statements referred to above include only a part of the financial data of the Valley Springs Volunteer Fire Department which is considered a part of the primary government. All of the financial data of the Department should be included in order to conform with accounting principles generally accepted in the United States of America. It was not considered practicable to determine the effects of this omission on the assets, liabilities, fund equity, revenues, and expenditures of the general fund and the assets and fund equity of the general fixed assets account group and the assets and liabilities of the general long-term debt account group.

A primary government is a legal entity or body politic and includes all funds, organizations, institutions, agencies, departments, and offices that are not legally separate. Such legally separate entities are referred to as component units. In my opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had I been able to determine the propriety of amounts reported for general fixed assets, enterprise fund fixed assets, accumulated depreciation and related depreciation expense and the effects on the financial statements of the omission described in the third and fourth paragraphs, the primary government financial statements referred to above present fairly, in all material respects, the financial position of the primary government of the Municipality of Valley Springs as of December 31, 2003, and the results of its operations and the cash flows of its proprietary fund types for the two years then ended in conformity with accounting principles generally accepted in the United States of America.

However, the primary government financial statements, because they do not include the financial data of component units of the Municipality of Valley Springs, South Dakota, do not purport to, and do not, present fairly the financial position of the Municipality of Valley Springs, South Dakota, as of December 31, 2003 and the results of its operations and cash flows of its proprietary fund types for the two years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated May 4, 2005, on my consideration of the Municipality of Valley Springs' internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, and contracts. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and, in considering the results of this audit, this report should be read along with the independent auditor's report on the financial statements.

May 4, 2005


DONALD E. FINSTAD, CPA

Municipality of Valley Springs, South Dakota
Combined Balance Sheet--All Fund Types and Account Groups
December 31, 2003

	Governmental Fund Types	Proprietary Fund Types	Account Groups	
	General Fund	Enterprise Funds	General Fixed Assets	General Long-Term Debt
Liabilities and Equity				
Liabilities				
Accounts payable	\$ 4,558	\$ 8,563	\$ -	\$ -
Accrued interest payable	-	4,793		
Customer deposits	-	6,590	-	-
Deferred revenue	107,357	-	-	-
Revenue bonds payable	-	384,377	-	-
Other long-term debt	-	-	-	-
Total liabilities	<u>111,915</u>	<u>404,323</u>	<u>-</u>	<u>-</u>
Fund Equity				
Contributions from others	-	56,772	-	-
Investment in general fixed assets	-	-	593,588	-
Retained earnings:				
Reserved for revenue bond debt service	-	2,350	-	-
Unreserved	-	503,426	-	-
Fund balance:				
Designated for economic development	66,423			
Undesignated	150,122	-	-	-
Total fund equity	<u>216,545</u>	<u>562,548</u>	<u>593,588</u>	<u>-</u>
Total Liabilities and Equity	<u>\$ 328,460</u>	<u>\$ 966,871</u>	<u>\$ 593,588</u>	<u>\$ -</u>

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenditures and Changes in Fund Balances
All Governmental Fund Types
For the Year Ended December 31, 2003

	Governmental Fund Types <u>General</u>
Revenue:	
Taxes	\$ 133,608
Licenses and permits	7,548
Intergovernmental revenue	17,171
Charges for goods and services	149
Fines and forfeits	173
Miscellaneous revenue	12,953
Total revenue	<u>171,602</u>
Expenditures:	
General government	46,211
Public safety	47,302
Public works	32,305
Health and welfare	1,044
Culture and recreation	9,520
Conservation and development	300
Debt service	-
Miscellaneous	-
Total expenditures	<u>136,682</u>
Other financing sources (uses):	
Sales of general fixed assets	<u>25</u>
Excess of revenue and other sources over (under) expenditures and other uses	34,945
Unreserved fund balance, January 1, 2003	<u>181,600</u>
Unreserved fund balance, December 31, 2003	<u>\$ 216,545</u>

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual--General Fund
For the Year Ended December 31, 2003

	General Fund		
	Budget	Actual	Variance Favorable (Unfavorable)
Revenue:			
Taxes:			
General property taxes	\$ 99,392	\$ 95,790	\$ (3,602)
General sales and use taxes	33,000	37,553	4,553
Amusement taxes	160	144	(16)
Tax deed revenue	-	-	-
Penalties and interest on delinquent taxes	150	121	(29)
Total taxes	132,702	133,608	906
Licenses and permits	3,495	7,548	4,053
Intergovernmental revenue:			
State shared revenue:			
Bank franchise tax	2,000	2,247	247
Liquor tax reversion	4,000	3,908	(92)
Motor vehicle licenses (5%)	2,500	3,064	564
Local government highway and bridge fund	4,500	6,414	1,914
Other	425	480	55
County wheel tax	900	1,058	158
Total intergovernment revenue	14,325	17,171	2,846
Charges for goods and services:			
General government	100	85	(15)
Highways and streets	-	-	-
Health	175	64	(111)
Total charges for goods and services	275	149	(126)
Fines and forfeits:			
Court fines and costs	175	173	(2)
Miscellaneous revenue:			
Earnings on deposits and investments	3,500	3,955	455
Rentals	200	-	(200)
Contributions and donations from private sources	-	250	250
Other	-	8,748	8,748
Total miscellaneous revenue	3,700	12,953	9,253
Total revenue	154,672	171,602	16,930

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual--General Fund
For the Year Ended December 31, 2003

	General Fund		
	Budget	Actual	Variance Favorable (Unfavorable)
Expenditures:			
General government:			
Legislative	\$ 7,150	\$ 8,697	\$ (1,547)
Contingency	5,000		
(Amount transferred)	(5,000)		
Elections	385	327	58
Financial administration	18,945	15,912	3,033
Other	23,200	21,275	1,925
Total general government	49,680	46,211	3,469
Public safety:			
Police	23,738	23,738	-
Fire	36,000	23,564	12,436
Protective inspection	1,000	-	1,000
Total public safety	60,738	47,302	13,436
Public works:			
Highways and streets	56,650	29,683	26,967
Sanitation	2,700	2,622	78
Total public works	59,350	32,305	27,045
Health and welfare:			
Health	-	-	-
Humane Society	1,000	1,044	(44)
Total health and welfare	1,000	1,044	(44)
Culture and recreation:			
Recreation	-	-	-
Parks	10,425	9,520	905
Total culture and recreation	10,425	9,520	905
Economic development and assistance	-	300	(300)
Debt service	-	-	-
Miscellaneous:			
Other expenditures	-	-	-
Total expenditures	181,193	136,682	44,511
Other financing sources (uses):			
Sales of general fixed assets	-	25	25
Excess of revenue and other sources over (under) expenditures and other uses	(26,521)	34,945	61,466
Unreserved fund balance, January 1, 2003	181,600	181,600	-
Unreserved fund balance, December 31, 2003	\$ 155,079	\$ 216,545	\$ 61,466

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenses and Changes in Retained Earnings
All Proprietary Fund Types
For the Year Ended December 31, 2003

	Proprietary Fund Types Enterprise Funds
Operating revenue:	
Charges for goods and services	<u>\$ 130,826</u>
Operating expenses:	
Personal services	50,403
Other current expenses	26,012
Depreciation	29,177
Total operating expenses	<u>105,592</u>
Operating income (loss)	<u>25,234</u>
Nonoperating revenue (expense):	
Investment earnings	5,917
Interest expense and fiscal charges	(20,481)
Total nonoperating revenue (expense)	<u>(14,564)</u>
Net income (loss)	10,670
Unreserved retained earnings, January 1, 2003	<u>492,756</u>
Unreserved retained earnings, December 31, 2003	<u>\$ 503,426</u>

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Cash Flows
All Proprietary Fund Types
For the Year Ended December 31, 2003

	Proprietary Fund Types Enterprise Funds
Cash flows from operating activities:	
Operating income	
Adjustments to reconcile operating income to net cash provided by operating activities:	\$ 25,233
(Increase) Decrease in receivables	(2,420)
Depreciation and amortization expense	29,392
Increase (Decrease) in accounts payable	3,025
Increase (Decrease) in customer deposits	480
Net cash provided (used) by operating activities	55,710
Cash flows from noncapital financing activities:	
Operating grants	1,000
Cash flows from capital and related financing activities:	
Purchase of equipment	(3,783)
Debt repayment-principal	(15,492)
Debt repayment-interest	(20,735)
Cash flows from investing activities:	
Interest received	5,916
Net increase (decrease) in cash and cash equivalents during the year	22,616
Cash and cash equivalents at beginning of year	233,944
Cash and cash equivalents at end of year	\$ 256,560

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenditures and Changes in Fund Balances
All Governmental Fund Types
For the Year Ended December 31, 2002

	Governmental Fund Types General
Revenue:	
Taxes	\$ 124,556
Licenses and permits	5,805
Intergovernmental revenue	16,775
Charges for goods and services	198
Fines and forfeits	69
Miscellaneous revenue	17,680
Total revenue	<u>165,083</u>
Expenditures:	
General government	33,763
Public safety	34,365
Public works	58,495
Health and welfare	750
Culture and recreation	16,779
Conservation and development	740
Debt service	2,500
Miscellaneous	-
Total expenditures	<u>147,392</u>
Other financing sources (uses):	
Sales of general fixed assets	3,500
Compensation for loss or damage to general fixed assets	-
Total other financing sources (uses)	<u>3,500</u>
Excess of revenue and other sources over (under) expenditures and other uses	21,191
Unreserved fund balance, January 1, 2002	<u>160,409</u>
Unreserved fund balance, December 31, 2002	<u>\$ 181,600</u>

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual--General Fund
For the Year Ended December 31, 2002

	General Fund		
	Budget	Actual	Variance Favorable (Unfavorable)
Revenue:			
Taxes:			
General property taxes	\$ 93,338	\$ 91,263	\$ (2,075)
General sales and use taxes	30,000	32,971	2,971
Amusement taxes	160	156	(4)
Tax deed revenue	-	-	-
Penalties and interest on delinquent taxes	150	166	16
Total taxes	<u>123,648</u>	<u>124,556</u>	<u>908</u>
Licenses and permits	<u>3,405</u>	<u>5,805</u>	<u>2,400</u>
Intergovernmental revenue:			
State shared revenue:			
Bank franchise tax	2,500	2,099	(401)
Liquor tax reversion	3,600	3,896	296
Motor vehicle licenses (5%)	2,000	3,027	1,027
Local government highway and bridge fund	3,800	6,181	2,381
Other	400	507	107
County wheel tax	900	1,065	165
Total intergovernment revenue	<u>13,200</u>	<u>16,775</u>	<u>3,575</u>
Charges for goods and services:			
General government	150	70	(80)
Sanitation	-	-	-
Health	200	128	(72)
Culture and recreation	-	-	-
Total charges for goods and services	<u>350</u>	<u>198</u>	<u>(152)</u>
Fines and forfeits:			
Court fines and costs	250	69	(181)
Other	-	-	-
Total fines and forfeits	<u>250</u>	<u>69</u>	<u>(181)</u>
Miscellaneous revenue:			
Earnings on deposits and investments	5,000	3,053	(1,947)
Rentals	200	50	(150)
Contributions and donations from private sources	-	12,912	12,912
Other	1,300	1,665	365
Total miscellaneous revenue	<u>6,500</u>	<u>17,680</u>	<u>11,180</u>
Total revenue	<u>147,353</u>	<u>165,083</u>	<u>17,730</u>

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual--General Fund
For the Year Ended December 31, 2002

	General Fund		
	Budget	Actual	Variance Favorable (Unfavorable)
Expenditures:			
General government:			
Legislative	\$ 6,200	\$ 6,198	\$ 2
Contingency	5,000		
(Amount transferred)	(5,000)		
Elections	415	368	47
Financial administration	19,972	14,890	5,082
Other	13,460	12,307	1,153
Total general government	40,047	33,763	6,284
Public safety:			
Police	22,880	22,880	-
Fire	11,940	11,485	455
Protective inspection	800	-	800
Total public safety	35,620	34,365	1,255
Public works:			
Highways and streets	56,642	56,239	403
Sanitation	3,500	2,256	1,244
Total public works	60,142	58,495	1,647
Health and welfare:			
Health	-	-	-
Humane Society	1,000	750	250
Total health and welfare	1,000	750	250
Culture and recreation:			
Recreation	-	-	-
Parks	15,865	16,779	(914)
Total culture and recreation	15,865	16,779	(914)
Economic development and assistance	1,983	740	1,243
Debt service	3,260	2,500	760
Miscellaneous:			
Other expenditures	400	-	400
Total expenditures	158,317	147,392	10,925
Other operating sources (uses):			
Sales of general fixed assets	-	3,500	3,500
Compensation for loss or damage to general fixed assets	-	-	-
Total other financing sources (uses)	-	3,500	3,500
Excess of revenue and other sources over (under) expenditures and other uses	(10,964)	21,191	32,155
Unreserved fund balance, January 1, 2002	160,409	160,409	-
Unreserved fund balance, December 31, 2002	\$ 149,445	\$ 181,600	\$ 32,155

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Revenues, Expenses and Changes in Retained Earnings
All Proprietary Fund Types
For the Year Ended December 31, 2002

	<u>Proprietary Fund Types Enterprise Funds</u>
Operating revenue:	
Charges for goods and services	<u>\$ 119,391</u>
Operating expenses:	
Personal services	49,462
Other current expenses	32,168
Depreciation	27,715
Total operating expenses	<u>109,345</u>
Operating income (loss)	<u>10,046</u>
Nonoperating revenue (expense):	
Operating grants	9,000
Investment earnings	4,568
Interest expense and fiscal charges	(21,299)
Total nonoperating revenue (expense)	<u>(7,731)</u>
Net income (loss)	2,315
Unreserved retained earnings, January 1, 2002	<u>490,441</u>
Unreserved retained earnings, December 31, 2002	<u>\$ 492,756</u>

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Combined Statement of Cash Flows
All Proprietary Fund Types
For the Year Ended December 31, 2002

	Proprietary Fund Types Enterprise Funds
Cash flows from operating activities:	
Operating income	\$ 10,046
Adjustments to reconcile operating income to net cash provided by operating activities:	
(Increase) Decrease in receivables	(10,486)
Depreciation and amortization expense	27,930
Increase (Decrease) in accounts payable	5,475
Increase (Decrease) in customer deposits	1,380
Net cash provided (used) by operating activities	34,345
Cash flows from noncapital financing activities:	
Operating grants	4,000
Cash flows from capital and related financing activities:	
Purchase of equipment	(25,470)
Debt repayment-principal	(14,864)
Debt repayment-interest	(21,363)
Proceeds from issuance of long-term debt	-
Cash flows from investing activities:	
Interest received	4,568
Net increase (decrease) in cash and cash equivalents during the year	(18,784)
Cash and cash equivalents at beginning of year	252,728
Cash and cash equivalents at end of year	\$ 233,944

The notes to the financial statements are an integral part of this statement.

Municipality of Valley Springs, South Dakota
Notes to the Financial Statements

1. Summary of Significant Accounting Policies

a. Reporting Entity:

The funds and account groups included in this report are controlled by or dependent upon the municipality's governing board.

The accounting policies of the municipality conform to generally accepted accounting principles as applicable to governments.

The Valley Springs Housing and Redevelopment Commission is a component unit of the municipality in that the appointment of the board of directors is made by the governing board of the municipality and that board also maintains the right to approve significant transactions relating to the Commission. Financial information for this organization can be obtained from that organization. Financial information for the Commission has been omitted from the financial statements of the municipality.

The Valley Springs Volunteer Fire Department is considered a department of the municipality because it is not a legally separate organization. However, complete financial information was not available for inclusion in the financial statements. Financial information for this organization has been included in the amounts reported for the municipality but the amounts include only a portion of the total financial information for this organization.

b. Fund Accounting:

The accounts are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures, or expenses, as appropriate. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped, in the financial statements in this report, into two broad fund categories and two generic fund types as follows:

Governmental Funds:

General Fund – the General Fund is the general operating fund of the municipality. It is used to account for all financial resources except those required to be accounted for in another fund.

Proprietary Funds:

Enterprise funds – enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. The Water Fund and the Sewer Fund are the only enterprise funds maintained by the municipality.

The enterprise funds do not apply all FASB Statements and Interpretations issued after November 30, 1989.

c. Fixed Assets and Long-term Liabilities:

Fixed assets used in governmental fund type operations (general fixed assets) are accounted for in the general fixed assets account group, rather than in governmental funds. Public domain (infrastructure) general fixed assets consisting of certain improvements other than buildings, including bridges, curbs and gutters, streets and sidewalks, drainage systems, and lighting systems, are not capitalized along with other general fixed assets. No depreciation has been provided on general fixed assets.

All fixed assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated fixed assets are valued at their estimated fair value on the date donated.

Interest costs incurred during construction of fixed assets are capitalized along with other fixed asset costs.

It was not practicable to determine what percentage of the total balances of general fixed assets and proprietary fund fixed assets reported at December 31, 2003 were determined by estimates of historical cost.

Depreciation of all exhaustible fixed assets used by proprietary funds is charged as an expense against their operations. Accumulated depreciation is reported on proprietary fund balance sheets. Depreciation has been provided over the estimated useful lives using the straight-line method.

Long-term liabilities expected to be financed from governmental funds are accounted for in the general long-term account group, not in the governmental funds.

The two account groups are not "funds." They are concerned only with the measurement of financial position. They are not involved with measurement of results of operations.

d. Basis of Accounting:

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements.

All governmental funds are accounted for using the modified accrual basis of accounting. Their revenues are recognized when they become measurable and available. The revenues which are accrued at December 31, 2002 and December 31, 2003 are state and local sales and use taxes. Expenditures are generally recognized when the related fund liability is incurred. Exceptions to this general rule include principal and interest on general long-term debt which is recognized when due.

All proprietary funds are accounted for using the accrual basis of accounting. Their revenues are recognized when they are earned, and their expenses are recognized when they are incurred. There were no unbilled utility accounts receivable at December 31, 2002 or December 31, 2003.

e. Budgets and Budgetary Accounting:

The municipality follows these procedures in establishing the budgetary data reflected in the financial statements:

1. At the first regular board meeting in September of each year or within ten days thereafter, the governing board introduces the annual appropriation ordinance for the ensuing fiscal year.
2. After adoption by the governing board, the operating budget is legally binding and actual expenditures for each purpose cannot exceed the amounts budgeted, except as indicated in number 4.
3. A line item for contingencies may be included in the annual budget. Such a line item may not exceed 5 percent of the total municipal budget and may be transferred by resolution of the governing board to any other budget category that is deemed insufficient during the year.
4. If it is determined during the year that sufficient amounts have not been budgeted, state statute allows the adoption of supplemental budgets.
5. Unexpended appropriations lapse at year end unless encumbrances by resolution of the governing board.

Encumbrance accounting, under which purchase orders, contracts, and other Commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the General Fund.

The municipality did not encumber any amounts at either December 31, 2002 or December 31, 2003.

6. Formal budgetary integration is employed as a management control device during the year for the General Fund.
7. Budgets for the General Fund are adopted on a basis consistent with generally accepted accounting principles (GAAP).

f. Deposits and Investments:

The municipality follows the policy of aggregating the cash assets of various funds to maximize cash management efficiency and returns. Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits – The municipal deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 9-22-6, 9-22-6.1 and 9-22-6.2. Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by federal home loan banks accompanied by written evidence of that bank's public debt rating which may not be less than "AA" or a qualified public depository may furnish a corporate surety bond of a corporation authorized to do business in South Dakota.

Deposits are reported at cost, plus interest, if the account is of the add-on type.

State law allows income from deposits and investments to be credited to either the General Fund or the fund making the investments. The municipality's policy is to credit all income from deposits and investments to the fund making the investment.

The actual bank balances at December 31, 2003 were as follows:

	<u>Bank Balance</u>
Insured (FDIC/NCUA)	\$ 151,216
Uninsured, collateral jointly held by the municipality's agent in the name of the state and the pledging financial institution	<u>280,801</u>
Total deposits	<u>\$ 432,017</u>

The carrying amount of deposits on the December 31, 2003 balance sheet was \$424,584. Deposits and investments reported on the combined balance sheet at December 31, 2003, include \$100 of cash on hand.

Investments – In general, SDCL 4-5-6 permits municipal funds to be invested in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a); or in shares of an open-end, no-load fund administered by an investment company whose investments are in securities described in (a) and repurchase agreements described in (b). Also, SDCL 4-5-9 requires that investments shall be in the physical custody of the political subdivision or may be deposited in a safekeeping account with any bank or trust company designated by the political subdivision as its fiscal agent.

Investments are stated at fair value.

The entity's investments, except for mutual funds, are categorized to give an indication of the level of risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the entity or its agent in the entity's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the entity's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent but not in the entity's name.

The investments at December 31, 2003 (which are reported as interest bearing accounts) were as follows:

	<u>Fair Value</u>
Mutual Funds:	
SD Public Funds Government	
Cash Account (SDFIT)	<u>\$ 51,673</u>
Total investments	<u>\$ 51,673</u>

In addition to the aforementioned item, investments in U. S. government securities were also made during the two years ended December 31, 2003 but not owned as of the same date.

The SDFIT is an external investment pool created for South Dakota local government investing. It is regulated by a nine member board with representation

from municipalities, school districts and counties. The net asset value of SDFIT money market account is kept at one dollar per share by adjusting the rate of return on a daily basis. Earnings are credited to each account on a monthly basis.

g. Deferred Revenue:

Under the modified accrual basis of accounting, receivables may be measurable but not available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Reported deferred revenues are those where asset recognition criteria have been met but for which revenue recognition criteria have not been met.

h. Cash Flows:

The municipality pools its cash resources for depositing and investing purposes. The proprietary funds essentially have access to their cash resources on demand. Accordingly, all reported deposit and investment balances are considered to be cash equivalents for the purpose of the Statement of Cash Flows.

2. Property Tax

Property taxes attach as an enforceable lien on property as of January 1 of each year. Taxes are levied on or before October 1 and payable in two installments on or before April 30 and October 31 of the following year. The county bills and collects the municipality's taxes and remits them to the municipality.

The municipality is permitted by state statute to levy the following amounts of taxes per \$1,000 of taxable valuation of the property in the municipality:

General Fund	\$27
Bond Redemption Funds	Amounts Required By Bond Agreements
Judgment Fund (Upon Judgment Being Made)	\$10

State statute allows the tax rates to be raised by special election of the voters.

3. Changes in General Fixed Assets

A summary of changes in general fixed assets for the two years ended December 31, 2003 is as follows:

	<u>Balance 1-01-02</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 12-31-03</u>
Land	\$ 7,050	\$ 7,998	\$ -	\$ 15,048
Buildings	58,288	58,087	-	116,375
Improvements Other Than Buildings	211,077	-	-	211,077
Machinery and Equipment	<u>227,748</u>	<u>44,799</u>	<u>21,459</u>	<u>251,088</u>
TOTAL	<u>\$504,163</u>	<u>\$110,884</u>	<u>\$21,459</u>	<u>\$593,588</u>

4. Proprietary Fund Fixed Assets

A summary of proprietary fund type property, plant and equipment at December 31, 2003 is as follows:

	<u>Enterprise</u>
Land	\$ 70,040
Buildings	7,541
Improvements other than buildings	937,732
Machinery and equipment	6,099
Construction work in progress	-
Total	<u>1,021,412</u>
Less accumulated depreciation	<u>(349,920)</u>
Net proprietary fund fixed assets	<u>\$ 671,492</u>

5. Long-term Debt

A summary of the changes in long-term debt follows:

	<u>Revenue Bonds</u>	<u>Long-term Debt</u>	<u>Total</u>
Debt payable, 01-01-02	\$ 414,687	\$ 2,500	\$417,187
Retired Debt payable, 12-31-03	<u>(30,310)</u>	<u>(2,500)</u>	<u>(32,810)</u>
	<u>\$ 384,377</u>	<u>\$ ---</u>	<u>\$384,377</u>

Debt payable at December 31, 2003 is comprised of the following:

Revenue Bonds:

\$40,000 1975 Water Revenue Bonds; payable in annual installments of \$2,350 through 2015; 5% interest; repayment being financed by user revenues of the Water Enterprise Fund \$ 19,200

\$430,000 1998 State Revolving Fund Revenue Bonds; payable in quarterly installments of \$8,469 through 10-1-2019; 5.25% interest; repayment being financed by user revenues of the Sewer Enterprise Fund

Total revenue bonds 365,177
\$ 384,377

The annual requirements to amortize all debt outstanding as December 31, 2003, including interest payments of \$151,978, are as follows:

<u>Year Ending</u> <u>December 31</u>	<u>Revenue</u> <u>Bonds</u>
2004	\$ 36,227
2005	36,227
2006	36,227
2007	36,227
2008	36,227
2009-2013	181,135
2014-2018	<u>174,085</u>
TOTAL	<u>\$ 536,355</u>

6. Segment Information for Enterprise Funds

The Water Enterprise Fund and the Sewer Enterprise Fund are maintained by the municipality which provide water and sewer services financed partially by user charges. Segment information for enterprise funds is as follows:

	Year Ended December 31, 2003	
	Water Fund	Sewer Fund
Operating revenue	\$ 63,115	\$ 67,711
Operating expenses:		
Depreciation	11,685	17,493
Other	44,553	31,862
Operating income (loss)	6,877	18,356
Operating grants, entitlement and shared revenue	-	-
Operating transfers:		
In	-	-
Out	-	-
Tax revenue	-	-
Net nonoperating revenue (expense)	651	(15,216)
Net income (loss)	7,528	3,140
Current capital:		
Contributions	-	-
Transfers	-	-
Plant, property and equipment:		
Additions	3,784	-
Deletions	-	-
Net working capital	88,333	183,660
Bonds and other long-term liabilities outstanding, December 31, 2003:		
Payable from operating revenue	19,200	365,177
Payable from other sources	-	-
Total assets	263,834	703,036
Total liabilities	28,103	376,220
Fund equity	235,731	326,813

	Year Ended December 31, 2002	
	<u>Water Fund</u>	<u>Sewer Fund</u>
Operating revenue	\$ 62,882	\$ 56,509
Operating expenses:		
Depreciation	10,222	17,493
Other	42,271	39,359
Operating income (loss)	10,390	(343)
Operating grants, entitlement and shared revenue	4,500	4,500
Operating transfers:		
In	-	-
Out	-	-
Tax revenue	-	-
Net nonoperating revenue (expense)	4,684	(12,414)
Net income (loss)	15,073	(12,757)
Current capital:		
Contributions	-	-
Transfers	-	-
Plant, property and equipment:		
Additions	25,470	-
Deletions	-	-
Net working capital	74,228	177,047
Bonds and other long-term liabilities outstanding, December 31, 2002:		
Payable from operating revenue	20,524	379,412
Payable from other sources	-	-
Total assets	255,359	713,084
Total liabilities	27,156	389,408
Fund equity	228,203	323,676

7. Expenditures in Excess of Appropriations

This requirement is effectively met by the statements in this report because the municipality maintains only the General Fund.

8. Retirement Plan

All employees, except for part-time and temporary employees, participate in the South Dakota Retirement System (SDRS), a cost-sharing, multiple employer public employee retirement system established to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability and survivors benefits. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering and amending plan provisions are found in South Dakota Codified Law 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

General employees are required by state statute to contribute 6 percent of their salary to the plan, while public safety and judicial employees contribute at 8 percent and 9 percent. State statute also requires the employer to contribute an amount equal to the employee's contribution. The municipality's share of contributions to the SDRS for the fiscal years ended December 31, 2003, 2002 and 2001 were \$3,102, \$2,910 and \$2,559, respectively, equal to the required contributions each year.

9. Commitments and Contingencies

In the summer of 2003, the municipality determined that it will be necessary to begin replacing sewer lines and manholes in the sanitary sewer system. The sewer system is approximately 50 years old and will need to be replaced in stages. The first stage of the project will repair approximately 30% of the sewer system. The estimated cost of the project total approximately \$500,000. The project is expected to be financed with revenue bonds, state grants and local funds.

The municipality entered into a Debt Service Agreement with the Valley Springs Housing and Redevelopment Commission, a component unit of the municipality, dated June 12, 2001. Under the terms of this agreement, the municipality is guaranteeing to repay up to 25% of the Essential Function Housing Bond, Series 2001, up to a maximum of \$72,500 if the Commission is unable to service the debt. As of December 31, 2003, the municipality's guarantee amounted to \$70,685.

10. Risk Management

The municipality is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the period ended December 31, 2003, the municipality managed its risks as follows:

Employee Health Insurance – The municipality purchases health insurance for its employees from a commercial insurance carrier.

Liability Insurance – The municipality joined the South Dakota Public Assurance Alliance, a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The municipality pays an annual premium to the pool to provide coverage for governmental general liability, governmental officials liability, automobile liability and physical damage, and property insurance.

The agreement with the South Dakota Public Assurance Alliance provides that the above coverages will be provided to a \$2,000,000 limit. Member premiums are used by the pool for payment of claims and to pay for reinsurance for claims in excess of \$250,000 to the upper limit. The municipality carries deductibles ranging from \$250 to \$2,000 for these coverages.

The municipality does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from these risks have never exceeded the liability coverage.

Workmen's Compensation – The municipality joined the South Dakota Municipal League Worker's Compensation Fund, a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The municipality pays an annual premium to the pool to provide worker's compensation coverage for its employees. Coverage limits are set by state statute. The pool pays the first \$250,000 of any claim per individual. The pool has reinsurance which covers up to an additional \$1,750,000 per individual per incident.

The municipality does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from these risks have never exceeded the liability coverage.

Unemployment Benefits – The municipality provides coverage for unemployment benefits by paying into the Unemployment Compensation Fund established by state law and managed by the State of South Dakota.

11. Restricted Cash/Liabilities Payable from Restricted Cash

Restricted cash of the enterprise funds, reported at \$8,940, is subject to the following restrictions:

	Water Fund	Sewer Fund
Customer deposits	\$ 6,590	\$ -
Restricted for debt retirement required by 1975 water revenue bonds	<u>2,350</u>	<u>-</u>
	<u>\$ 8,940</u>	<u>\$ -</u>

12. Estimated Uncollectibles

Based on prior collection experience, the estimated allowance for uncollectibles for all reported receivables has been determined to be zero.

13. Reservations and Designations of Fund Balance/Retained Earnings

General Fund

The fund balance of the General Fund has been designated by the governing board in the amount of \$66,423 to be used only for economic development purposes.

Enterprise Funds

The retained earnings of the enterprise funds are reserved in the amount of one year's debt service requirements as required by GMAC Commercial Mortgage Corporation. The amounts are as follows:

Water Enterprise Fund	\$ 2,350
Sewer Enterprise Fund	-

14. Interest Costs—Enterprise Funds

	Year Ended December 31, 2003	
	Water	Sewer
Interest costs incurred	\$ 1,026	\$ 19,455
Interest costs capitalized	-	-
Interest costs charged to expense	1,026	19,455
	Year Ended December 31, 2002	
	Water	Sewer
Interest costs incurred	\$ 1,111	\$ 20,188
Interest costs capitalized	-	-
Interest costs charged to expense	1,111	20,188

15. Subsequent Events

On August 10, 2004, the municipality signed a contract to refurbish the east well for an amount not to exceed \$12,900. This cost is to be borne by the Water Fund.

On October 12, 2004, the municipality received approval from the South Dakota Department of Environment and Natural Resources for a 3.25%, 20-year Clean Water State Revolving Fund loan in the amount of \$350,000 to partially finance improvements to the municipality's sanitary sewer system. Construction of the improvements is to begin in the summer of 2005. On June 25, 2004, the municipality was awarded a Consolidated Water Facilities Construction Program grant in the amount of \$75,000 to partially finance these same improvements.

On August 9, 2004, Valley Springs Volunteer Fire Department incorporated under the laws of the state of South Dakota. Upon incorporation, the municipality transferred eight vehicles to this nonprofit corporation. The costs at which these vehicles had been reported by the municipality could not be determined due to the nature of the fixed asset records.

16. Accounting Principles Change

On June 10, 1999, the Governmental Accounting Standards Board (GASB) issued Statement of Governmental Accounting Standards No. 34 – Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments (No. 34). GASB No. 34 establishes new requirements for the annual financial reports for state and local governments, including states, cities, towns, villages, counties, school districts and special purpose governments. For the municipality, GASB No. 34 implementation is first required for the calendar year ended December 31, 2004. The effect of the implementation of GASB No. 34 on the financial statements of the municipality has not yet been determined.

Municipality of Valley Springs, South Dakota
Schedule of Municipal Officials
December 31, 2003

Mayor:

Larry Bakker

Commissioners:

Carl Moss

Lonnie Kirby

Debbie Peterson-Bechtold

Jolene Jansma

Finance Officer:

Sandy Severtson

Attorney:

Todd Meierhenry